



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

– Article IV, Section 53 of the Michigan Constitution

Audit report information can be accessed at:

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Michigan *Office of the Auditor General* **REPORT SUMMARY**

Financial Audit

Michigan Economic Development Corporation

(A Discretely Presented Component Unit of the State of Michigan)

October 1, 2005 through September 30, 2007

Report Number:
271-0406-08

Released:
May 2008

A financial audit determines if the financial statements are fairly presented; considers internal control over financial reporting; and determines compliance with requirements material to the financial statements. This financial audit of the Michigan Economic Development Corporation (MEDC) was conducted as part of the constitutional responsibility of the Office of the Auditor General.

Financial Statements:

Auditor's Report Issued

We issued an unqualified opinion on MEDC's financial statements.

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Internal Control Over Financial Reporting

We identified one significant deficiency in internal control over financial reporting (Finding 1). We do not consider this significant deficiency to be a material weakness.

MEDC's controls over financial reporting did not detect a misclassification of revenue in its draft financial statements (Finding 1).

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Noncompliance and Other Matters Material to the Financial Statements

We did not identify any instances of noncompliance or other matters applicable to the financial statements that are required to be reported under *Government Auditing Standards*.

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Background:

MEDC's mission is to promote smart economic growth by developing strategies and providing services to create and retain good jobs and a high quality of life for Michigan residents. Article VII, Section 28 of the State Constitution and Act 7, P.A. 1967, provided for the creation of MEDC as a public body corporate. MEDC was created in April 1999 by a 10-year contract (interlocal agreement, as amended) between a participating local economic development corporation formed under Act 338, P.A. 1974, as amended, and the Michigan Strategic Fund.

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Agency Response:

Our audit report contains 1 finding and 1 corresponding recommendation. MEDC's preliminary response indicates that it agrees with the recommendation.

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A copy of the full report can be
obtained by calling 517.334.8050
or by visiting our Web site at:
<http://audgen.michigan.gov>



Michigan Office of the Auditor General
201 N. Washington Square
Lansing, Michigan 48913

Thomas H. McTavish, C.P.A.
Auditor General

Scott M. Strong, C.P.A., C.I.A.
Deputy Auditor General



STATE OF MICHIGAN
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

May 23, 2008

Mr. James C. Epolito, President and Chief Executive Officer
Michigan Economic Development Corporation
300 North Washington Square
Lansing, Michigan

Dear Mr. Epolito:

This is our report on the financial audit of the Michigan Economic Development Corporation (MEDC), a discretely presented component unit of the State of Michigan, for the period October 1, 2005 through September 30, 2007.

This report contains our report summary, our independent auditor's report on the financial statements, the MEDC management's discussion and analysis, and the MEDC financial statements. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters; our finding, recommendation, and agency preliminary response; and a glossary of acronyms and terms.

The agency preliminary response was taken from the agency's response subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

A handwritten signature in black ink that reads "Thomas H. McTavish".

Thomas H. McTavish, C.P.A.
Auditor General

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INDEPENDENT AUDITOR'S REPORT



STATE OF MICHIGAN
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on the Financial Statements

Mr. James C. Epolito, President and Chief Executive Officer
Michigan Economic Development Corporation
300 North Washington Square
Lansing, Michigan

Dear Mr. Epolito:

We have audited the accompanying financial statements of the Michigan Economic Development Corporation, a discretely presented component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2007 and September 30, 2006, as identified in the table of contents. These financial statements are the responsibility of the Michigan Economic Development Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial statements present only the Michigan Economic Development Corporation and do not purport to, and do not, present fairly the financial position of the State of Michigan or its component units as of September 30, 2007 and September 30, 2006 and the changes in financial position and cash flows thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.


In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Michigan Economic Development

Corporation as of September 30, 2007 and September 30, 2006 and the changes in financial position and cash flows for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 16, 2008 on our consideration of the Michigan Economic Development Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 11 through 15 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it. The management's discussion and analysis for the comparison between the fiscal years ended September 30, 2006 and September 30, 2005 was not presented because this information was presented with the Michigan Economic Development Corporation's prior year audited financial statements.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish". The signature is fluid and cursive, with a horizontal line extending from the left side of the name.

Thomas H. McTavish, C.P.A.
Auditor General
April 16, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Michigan Economic Development Corporation (MEDC) management has prepared this discussion and analysis of the financial performance of MEDC for the period October 1, 2006 through September 30, 2007. MEDC is a public body corporate and a discretely presented component unit of the financial reporting entity of the State of Michigan. MEDC's management is responsible for the financial statements, notes to the financial statements, and this discussion.

Using the Financial Report

This financial report is prepared in accordance with Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*.

The reporting standards require a statement of net assets; a statement of revenues, expenses, and changes in fund net assets; and a statement of cash flows (direct method). This financial report includes the reports of independent auditors, management's discussion and analysis, the basic financial statements, and the notes to the financial statements. Amounts reported in the financial statements include both the MEDC corporate funds as well as the State funds made available to MEDC.

The financial statements are interrelated and represent the financial status of MEDC. The statement of net assets presents assets and liabilities as of the end of the fiscal year. The statement of revenues, expenses, and changes in fund net assets presents the revenues earned and expenses incurred during the fiscal year. The statement of cash flows presents information related to cash in-flows and out-flows summarized by operating, noncapital financing, capital and related financing, and investing activities.

Major Changes

A settlement was effective March 2008 allowing MEDC to recognize \$26.9 million in tribal gaming revenue in fiscal year 2006-07.

In fiscal year 2005-06, effective November 21, 2005, Act 225, P.A. 2005, required MEDC to transfer \$68.7 million in cash, loans, and investments related to its Life Sciences and Technology Tri-Corridor programs to the Michigan Strategic Fund (MSF). Act 225, P.A. 2005, also required MEDC to transfer assets and liabilities of \$4.1 million each for the Capital Access Program to MSF.

Analysis of Financial Activities

The assets of MEDC exceeded its liabilities at September 30, 2007 by \$108.4 million and by \$87.6 million at September 30, 2006. As of September 30, 2007, \$24.8 million of this amount was in equity in common cash of the State of Michigan.

MEDC's total net assets increased by \$20.8 million during fiscal year 2006-07 primarily because of the \$26.9 million settlement of tribal gaming revenues (see Note 8). During fiscal year 2005-06, MEDC's total net assets decreased by \$77.3 million as a result of the transfer of \$68.7 million in assets of the Life Sciences and Technology Tri-Corridor programs to MSF and use of assets to fund MEDC's operations.

Condensed Financial Information From the Statement of Net Assets As of September 30

	<u>2007</u>	<u>2006</u>
Current assets	\$ 79,285,856	\$ 56,961,416
Noncurrent assets		
Loans receivable	25,424,785	27,497,212
Investments	4,081,765	5,342,821
Capital assets (net)	10,639,280	11,019,063
Total assets	<u>\$ 119,431,686</u>	<u>\$ 100,820,511</u>
Current liabilities	\$ 9,724,255	\$ 11,631,659
Long-term liabilities	1,285,264	1,585,369
Total liabilities	<u>\$ 11,009,520</u>	<u>\$ 13,217,028</u>
Net assets		
Invested in capital assets	\$ 10,639,280	\$ 11,019,063
Unrestricted net assets	<u>97,782,887</u>	<u>76,584,421</u>
Total net assets	<u>\$ 108,422,166</u>	<u>\$ 87,603,484</u>

Current assets primarily consist of amounts in the State of Michigan's equity in common cash, cash and cash equivalents, short-term investments, short-term loans receivable, amounts due from MSF, and receivables for gaming revenues. Interest

earned on funds retained in the common cash pool is the income of the State and is not transferred to MEDC.

Current assets increased by \$22.3 million in fiscal year 2006-07 primarily because of the \$26.9 million tribal gaming revenue settlement (See Note 8).

Loans receivable include the long-term portion of the outstanding loans, net of loan loss provisions. Long-term loans receivable decreased by \$2.1 million in fiscal year 2006-07 primarily because an Urban Land Assembly loan was repaid and a portion of remaining Urban Land Assembly loans was reclassified as current for loans expected to be repaid in fiscal year 2007-08.

Investments include long-term securities and program investments. During fiscal year 2006-07, total noncurrent investments declined by \$1.3 million primarily because MEDC had to liquidate some investments to offset reductions in tribal gaming revenues before the settlement.

Capital assets (net) at September 30, 2007 included the cost of the MEDC headquarters building, furniture, and information technology equipment, net of depreciation. During fiscal year 2006-07, capital assets worth \$153,478 were added.

Current liabilities primarily consist of accounts payable and the current portion of the compensated absences. The current liabilities decreased by \$1.9 million during fiscal year 2006-07 mainly because of the reduction of accounts payable recorded for the Economic Development Job Training Program.

Long-term liabilities primarily consisted of \$1.3 million in long-term compensated absences, which decreased by \$0.3 million in fiscal year 2006-07.

Overall, **net assets** increased by \$20.8 million during fiscal year 2006-07 as a result of the preceding activities.

Condensed Financial Information
From the Statement of Revenues, Expenses, and Changes in Fund Net Assets
For the Fiscal Years Ended September 30

	<u>2007</u>	<u>2006</u>
Operating revenues		
Operating grants and contributions	\$ 62,306,723	\$ 37,350,677
Interest and investment earnings	2,176,942	1,312,088
Other operating revenues	7,700,377	8,129,233
Total operating revenues	<u>\$ 72,184,043</u>	<u>\$ 46,791,998</u>
Operating expenses		
Salaries, wages, and other administrative expenses	\$ 31,249,349	\$ 33,163,126
Payment to MSF	183,359	3,945
Operating grants	19,932,652	22,230,462
Total operating expenses	<u>\$ 51,365,360</u>	<u>\$ 55,397,533</u>
Operating income (loss)	\$ 20,818,683	\$ (8,605,535)
Nonoperating revenues (expenses)		<u>(68,672,599)</u>
Change in net assets	\$ 20,818,683	\$ (77,278,134)
Total net assets - Beginning	<u>87,603,484</u>	<u>164,881,618</u>
Total net assets - Ending	<u><u>\$ 108,422,166</u></u>	<u><u>\$ 87,603,484</u></u>

Operating grants and contributions included \$4.4 million for two federal grants, \$29.0 million received from State funding for the economic development programs, and \$28.9 million in tribal gaming revenue and miscellaneous fees received by MSF and transferred to MEDC. In fiscal year 2006-07, operating grants and contributions increased by \$25.0 million primarily because of the \$26.9 million tribal gaming revenue settlement (see Note 8).

Interest and investment earnings for fiscal year 2006-07 increased by \$0.9 million primarily from capital gains from selling a venture capital investment.

Other operating revenues primarily consisted of revenues reimbursed by the Michigan Department of Transportation for the Welcome Center operations of \$4.3 million and tribal gaming revenues of \$2.7 million received directly by MEDC. MEDC receives tribal gaming revenue from the Keweenaw Bay Indian Community of 8% of the net win derived from all class III electronic games of chance.

Salaries, wages, and other administrative expenses for fiscal year 2006-07 were \$1.9 million lower because of general cost-cutting measures by MEDC and a reduction in required retirement contributions for State employees.

Operating grants for fiscal year 2006-07 included grants for the Economic Development Job Training Program, Michigan Manufacturing Technical Institute, and pass-through federal funds for 21st Century Workforce Regional Grants, and marketing program expenses. Operating grants decreased by \$2.3 million primarily because of a reduction in requests for Economic Development Job Training Program grants.

Nonoperating expenses in fiscal year 2005-06 consisted of \$68.7 million in assets and liabilities transferred from MEDC to MSF as explained under the "Major Changes" discussion.

Condensed Financial Information
From the Statement of Cash Flows
For the Fiscal Years Ended September 30

	2007	2006
Cash provided (used) by:		
Operating activities	\$ (7,862,724)	\$ (13,945,751)
Noncapital financing activities		(49,644,419)
Capital and related financing activities	(153,478)	(68,511)
Investing activities	23,021,268	7,404,104
Net increase (decrease) in cash	\$ 15,005,066	\$ (56,254,577)
Cash and cash equivalents at beginning of year	30,886,876	87,141,452
Cash and cash equivalents at end of year	<u>\$ 45,891,942</u>	<u>\$ 30,886,876</u>

Cash and cash equivalents at the end of fiscal year 2006-07 (\$45.9 million) included \$24.8 million equity in the State of Michigan common cash. The balance of the cash on hand (\$21.1 million) represented investments in instruments with maturity dates of less than 12 months.

In fiscal year 2005-06, the noncapital financing activities related to the transfer of assets and liabilities to MSF as described under "Major Changes."

FINANCIAL STATEMENTS

MICHIGAN ECONOMIC DEVELOPMENT CORPORATION
Statement of Net Assets
As of September 30

	<u>2007</u>	<u>2006</u>
ASSETS		
Current assets:		
Cash (Note 2)	\$ 638,199	\$ 833,995
Equity in common cash (Note 2)	24,776,065	26,938,615
Money market fund (Note 2)	20,477,678	3,114,266
Tribal gaming revenue receivable (Note 8)	2,022,190	1,431,523
Amounts due from MSF (Note 8)	26,880,000	154,161
Amounts due from federal agencies	518,422	610,419
Loans receivable (Note 3)	2,541,822	1,791,033
Investments (Note 2)	700,217	20,487,769
Other current assets:		
Interest receivable	72,031	422,446
Miscellaneous	659,232	1,177,189
Total current assets	<u>\$ 79,285,856</u>	<u>\$ 56,961,416</u>
Noncurrent assets:		
Loans receivable (Note 3)	\$ 25,424,785	\$ 27,497,212
Investments (Note 2)	4,081,765	5,342,821
Capital assets (net) (Note 4)	10,639,280	11,019,063
Total noncurrent assets	<u>\$ 40,145,830</u>	<u>\$ 43,859,095</u>
Total assets	<u>\$ 119,431,686</u>	<u>\$ 100,820,511</u>
LIABILITIES		
Current liabilities:		
Accounts payable and other liabilities	\$ 8,356,632	\$ 10,255,186
Compensated absences (Note 5)	1,279,003	1,178,787
Amounts due to primary government	88,621	160,598
Deferred revenues		37,089
Total current liabilities	<u>\$ 9,724,255</u>	<u>\$ 11,631,659</u>
Long-term liabilities:		
Compensated absences (Note 5)	\$ 1,283,906	\$ 1,543,567
Other long-term liabilities	1,358	41,801
Total long-term liabilities	<u>\$ 1,285,264</u>	<u>\$ 1,585,369</u>
Total liabilities	<u>\$ 11,009,520</u>	<u>\$ 13,217,028</u>
NET ASSETS		
Invested in capital assets	\$ 10,639,280	\$ 11,019,063
Unrestricted net assets	<u>97,782,887</u>	<u>76,584,421</u>
Total net assets (Note 9)	<u>\$ 108,422,166</u>	<u>\$ 87,603,484</u>

The accompanying notes are an integral part of the financial statements.

MICHIGAN ECONOMIC DEVELOPMENT CORPORATION
Statement of Revenues, Expenses, and Changes in Fund Net Assets
For the Fiscal Years Ended September 30

	<u>2007</u>	<u>2006</u>
OPERATING REVENUES (Note 1)		
<u>Operating grants and contributions</u>		
Federal revenue	\$ 4,414,750	\$ 2,530,080
Payments from MSF - State appropriations (Note 7)	28,993,355	33,513,501
Payments from MSF - Tribal gaming revenue and fees (Notes 7 and 8)	28,898,619	1,307,097
Total operating grants and contributions	<u>\$ 62,306,723</u>	<u>\$ 37,350,677</u>
<u>Interest and investment earnings</u>		
Investment earnings	\$ 929,462	\$ 1,703,547
Net increase (decrease) in fair value of investments	692,784	(772,715)
Interest income on loans	554,697	356,897
Interest income		24,357
Total interest and investment earnings	<u>\$ 2,176,942</u>	<u>\$ 1,312,088</u>
<u>Other operating revenues</u>		
Tribal gaming revenue (Note 8)	\$ 2,697,509	\$ 2,575,484
Other operating revenues	5,002,868	5,553,749
Total other operating revenues	<u>\$ 7,700,377</u>	<u>\$ 8,129,233</u>
Total operating revenues	<u>\$ 72,184,043</u>	<u>\$ 46,791,998</u>
OPERATING EXPENSES (Note 1)		
Salaries, wages, and other administrative expenses	\$ 31,249,349	\$ 33,163,126
Payment to MSF	183,359	3,945
Operating grants	19,932,652	22,230,462
Total operating expenses	<u>\$ 51,365,360</u>	<u>\$ 55,397,533</u>
Operating income (loss)	<u>\$ 20,818,683</u>	<u>\$ (8,605,535)</u>
Nonoperating revenues (expenses)		
Revenue from Capital Access Program liabilities transferred to MSF	\$	\$ 4,060,788
Expenses for Capital Access Program assets transferred to MSF		(4,060,788)
Expenses for Life Sciences and Technology Tri-Corridor assets transferred to MSF		(68,672,599)
Total nonoperating revenues (expenses)	<u>\$ 0</u>	<u>\$ (68,672,599)</u>
Change in net assets	\$ 20,818,683	\$ (77,278,134)
Total net assets - Beginning	<u>87,603,484</u>	<u>164,881,618</u>
Total net assets - Ending	<u><u>\$ 108,422,166</u></u>	<u><u>\$ 87,603,484</u></u>

The accompanying notes are an integral part of the financial statements.

MICHIGAN ECONOMIC DEVELOPMENT CORPORATION
Statement of Cash Flows
For the Fiscal Years Ended September 30

	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Payments to employees	\$ (19,739,217)	\$ (19,152,718)
Payments to suppliers	(11,248,736)	(14,138,880)
Tribal gaming revenue	2,106,842	2,967,753
Other operating revenue	6,075,522	5,311,109
Grants received from federal government	4,506,746	2,541,216
Operating grants	(20,546,657)	(26,136,722)
Payment to MSF	(183,359)	(3,945)
Payments from MSF	31,166,135	34,666,436
Net cash provided (used) by operating activities	<u>\$ (7,862,724)</u>	<u>\$ (13,945,751)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Nonoperating expenses	\$	\$ (49,644,419)
Net cash provided (used) by noncapital financing activities	<u>\$ 0</u>	<u>\$ (49,644,419)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets (Note 4)	\$ (153,478)	\$ (68,511)
Net cash provided (used) by capital and related financing activities	<u>\$ (153,478)</u>	<u>\$ (68,511)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale and maturities of investment securities	\$ 21,741,392	\$ 5,887,017
Interest and dividends on investments	1,279,877	1,517,088
Net cash provided (used) by investing activities	<u>\$ 23,021,268</u>	<u>\$ 7,404,104</u>
Net cash provided (used) - All activities	\$ 15,005,066	\$ (56,254,577)
Cash and cash equivalents at beginning of year	<u>30,886,876</u>	<u>87,141,452</u>
Cash and cash equivalents at end of year	<u><u>\$ 45,891,942</u></u>	<u><u>\$ 30,886,876</u></u>
RECONCILIATION OF CASH AND CASH EQUIVALENTS		
Per statement of net assets classifications:		
Cash	\$ 638,199	\$ 833,995
Equity in common cash	24,776,065	26,938,615
Money market mutual funds	<u>20,477,678</u>	<u>3,114,266</u>
Cash and cash equivalents at end of year	<u><u>\$ 45,891,942</u></u>	<u><u>\$ 30,886,876</u></u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:		
Operating income (loss)	\$ 20,818,683	\$ (8,605,535)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Interest (nonprogram) and investment income	(1,279,877)	(1,517,088)
Depreciation	533,261	512,705
Net increase (decrease) in fair value of investments	(692,784)	772,715
Changes in assets and liabilities:		
Amounts due from MSF and tribal gaming revenue receivable	(27,316,505)	238,108
Loans receivable (program loans)	1,321,638	1,799,213
Amounts due from federal agencies	91,996	11,136
Other assets	868,372	(810,355)
Accounts payable and other liabilities	<u>(2,207,508)</u>	<u>(6,346,650)</u>
Net cash provided (used) by operating activities	<u><u>\$ (7,862,724)</u></u>	<u><u>\$ (13,945,751)</u></u>
SCHEDULE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Loans transferred to MSF	\$	\$ (15,097,006)
Investment transferred to MSF		(8,249,130)
Loans converted to grants		203,960
Increase/(decrease) in fair value of investments	<u>(893,892)</u>	<u>(772,715)</u>
Net noncash provided (used) by investing, capital, and financing activities	<u><u>\$ (893,892)</u></u>	<u><u>\$ (23,914,890)</u></u>

The accompanying notes are an integral part of the financial statements.

Notes to the Financial Statements

Note 1 Significant Accounting Policies

The accounting policies of the Michigan Economic Development Corporation (MEDC) conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of the more significant policies:

a. Reporting Entity

Article VII, Section 28 of the State Constitution and Act 7, P.A. 1967, provided for the creation of MEDC as a public body corporate. MEDC was created in April 1999 by a 10-year contract (interlocal agreement, as amended) between a participating local economic development corporation formed under Act 338, P.A. 1974, as amended, and the Michigan Strategic Fund (MSF). MEDC is a separate legal entity created to promote smart economic growth by developing strategies and providing services to create and retain good jobs and a high quality of life for Michigan residents. Under the terms of the agreement, the governance of MEDC resides in an Executive Committee of 20 members appointed to eight-year, staggered terms by the Governor.

MEDC is a discretely presented component unit of the financial reporting entity of the State of Michigan. MEDC is a component unit in the State of Michigan reporting entity because the primary government appoints the governing board of MEDC and there is a potential for MEDC to provide specific financial benefits to, or impose specific financial burdens on, the State.

b. Financial Statement Presentation

The basic financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

MEDC follows the business type activities reporting requirements of GASB Statement No. 34, which provides for a statement of net assets; a statement of revenues, expenses, and changes in fund net assets; and a statement of cash flows.

MEDC's operations are financed and operated in a manner similar to private business enterprises, i.e., where the intent of the governing body is that the costs (expenses) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The accompanying financial statements present only MEDC. Accordingly, they do not purport to, and do not, present fairly the financial position and the changes in financial position and cash flows of the State of Michigan or its component units in conformity with accounting principles generally accepted in the United States of America (GAAP).

c. Measurement Focus and Basis of Accounting

The financial statements contained in this report are presented using the economic resources measurement focus and the full accrual basis of accounting as provided by GAAP applicable to governments. Under the full accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows.

d. Financial Data

The MSF Board of Directors entered into an interlocal agreement with a local unit of government to create MEDC. MEDC came into existence on April 5, 1999. In accordance with the terms of the agreement, substantial assets, liabilities, and fund balances of MSF were transferred to MEDC on May 1, 1999. All revenues received from tribal gaming, industrial development revenue bond (IDRB) issuance fees, and Michigan Economic Growth Authority and Brownfield fees are transferred to MEDC on a monthly basis. This interlocal agreement also detailed all of MSF's State classified employees to MEDC. State appropriations available to MSF for this purpose are also made available to MEDC, as needed.

Effective November 21, 2005, Act 225, P.A. 2005, required MEDC to transfer \$68.7 million, in cash, loans, and investments related to MEDC's Life Sciences and Technology Tri-Corridor programs to MSF. Act 225,

P.A. 2005, also reestablished the Capital Access Program within MSF and required the transfer of the assets and liabilities related to the Program from MEDC to MSF.

MEDC financial statements primarily present the following:

- (1) Cash and Cash Equivalents: The amount reported as "Cash and cash equivalents at end of year" on the statement of cash flows is equal to the total of the amounts reported on the statement of net assets for the line items entitled "Cash," "Equity in common cash," and "Money market fund."
- (2) Amounts Due From MSF: Amounts due from MSF includes the tribal gaming revenue settlement (see Note 8).
- (3) Investments: MEDC reports marketable investments at fair value and other nonmarketable investments at cost.
- (4) Loans Receivable: Loans receivable are reported net of allowance for losses.
- (5) Capital Assets: Capital assets, which mainly include a building, furniture, and equipment, are reported at historical cost, net of depreciation.
- (6) Operating Revenues: Operating revenues include revenues from federal grants, other restricted sources (see Note 7), amounts available to MEDC from State appropriations (see Note 7), tribal gaming revenue (see Note 8), and investment earnings. Also included in operating revenues are IDRIB issuance fees and Michigan Economic Growth Authority and Brownfield fees collected by MSF and transferred to MEDC during the fiscal year.
- (7) Operating Expenses: Operating expenses include expenses related to program grants funded by State appropriations transferred to MEDC and MEDC nonappropriated funds. Also included in operating expenses are administrative expenses incurred from State appropriations transferred to MEDC.

Note 2 Deposits and Investments

a. General Information

MEDC's investment policy allows investments in the following investment types:

- (1) Securities issued or guaranteed by the U.S. government or its agencies.
- (2) Bonds or other obligations of any U.S. state or any local unit of government of any such state.
- (3) Preferred stock issued by U.S. corporations.
- (4) Repurchase agreements fully collateralized by U.S. government securities.
- (5) Corporate and bank debt including, but not limited to, commercial paper, banker's acceptances, and other short-term obligations.
- (6) Corporate notes and bonds.
- (7) Taxable bond funds.
- (8) Money market mutual fund shares that offer daily purchase and redemption and maintain a constant share price.
- (9) Common stock of U.S. corporations.
- (10) Stock mutual funds with portfolios highly concentrated in securities of U.S. corporations.

b. Deposits

	As of September 30	
	2007	2006
Equity in State of Michigan common cash	\$ 24,776,065	\$ 26,938,615
Checking	408,553	113,995
Money market account	229,646	720,000
Total deposits	<u>\$ 25,414,264</u>	<u>\$ 27,772,610</u>

Custodial Credit Risk: Governmental accounting standards require disclosures related to custodial credit risks for deposits. Custodial credit risk for deposits is the risk that, in the event of a bank failure, MEDC's deposits may not be returned to it. Deposits are exposed to custodial credit risk if they are not covered by depository insurance and are uncollateralized, collateralized with securities held by the pledging financial institution, or collateralized with securities held by the pledging financial institution's trust department or agent but not in MEDC's name.

Deposits included in MEDC's bank accounts (without recognition of outstanding checks or deposits in transit) were \$521,681 at September 30, 2007 (\$633,480 at September 30, 2006). Of that amount, \$377,938 (\$523,645 at September 30, 2006) was uninsured and uncollateralized at September 30, 2007. There were no deposits collateralized with securities held by the pledging financial institution or by the pledging financial institution's trust department or agent but not in MEDC's name. MEDC has no policy for controlling custodial credit risk.

MEDC's deposits included in the State of Michigan's equity in common cash are managed by the State Treasurer. The State Treasurer's policy requires financial institutions to secure State funds with collateral, be organized under federal or State law, maintain an office in Michigan, and restricts deposits to a maximum of 50% of the financial institution's net worth. As of September 30, 2007 and September 30, 2006, 99.8% and 99.7%, respectively, of the State's common cash was covered by either federal depository insurance or collateralized with securities held in the State's name by the State's agent. Additional details on this policy are

described in Note 5 of the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*.

c. Investments

All marketable investments are reported at fair value. Equity investments in business and industrial development corporations (BIDCOs) are reported using cost-based measures, which MEDC has determined approximates fair value.

MEDC makes grant commitments as a part of its economic development mission. These commitments are paid from the proceeds of the investments held in short-term and long-term securities. The timing of cash required for program commitments is dependent upon the completion of projects, and MEDC attempts to match investment maturities with its cash flow needs to meet grant commitments. For this reason, investments have frequent turnover. Therefore, the proceeds from sales and maturities of all investments are shown as a net balance on the statement of cash flows.

Governmental accounting standards require disclosures for investments for interest rate risk, custodial credit risk, credit risk, foreign currency risk, and concentration of credit risk:

The following table shows the fair value of investments at September 30, 2007 by investment type and in total:

	Fair Value	Investment Maturities			
		Less Than 1 Year	1 to 5 Years	6 to 10 Years	More Than 10 Years
<u>Investment Type</u>					
Money market fund	\$20,477,678	\$20,477,678	\$	\$	\$
Government securities	911,149	700,217			210,932
Equities	720,666		720,666		
Venture capital	3,150,167			3,150,167	
Total investments	<u>\$25,259,661</u>	<u>\$21,177,895</u>	<u>\$720,666</u>	<u>\$3,150,167</u>	<u>\$ 210,932</u>

The following table shows the fair value of investments at September 30, 2006 by investment type and in total:

Investment Type	Fair Value	Investment Maturities			
		Less Than 1 Year	1 to 5 Years	6 to 10 Years	More Than 10 Years
Commercial paper	\$7,603,066	\$ 7,603,066	\$	\$	\$
Money market fund	3,114,266	3,114,266			
Government securities	13,301,409	12,884,703			416,706
Equities	1,592,154		1,592,154		
Venture capital	3,333,962			3,333,962	
Total investments	<u>\$28,944,857</u>	<u>\$23,602,035</u>	<u>\$1,592,154</u>	<u>\$3,333,962</u>	<u>\$ 416,706</u>

- (1) Interest Rate Risk: Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of those investments. MEDC does not have a policy regarding interest rate risk. As of September 30, 2007, investments in money market fund and government securities with a market value of \$21.4 million were exposed to interest rate risk. As of September 30, 2006, investments in commercial paper, money market fund, and government securities with a market value of \$24.0 million were exposed to interest rate risk.
- (2) Custodial Credit Risk: Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty to a transaction, MEDC will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of MEDC, and are held by either the counterparty or the counterparty's trust department or agent but not in MEDC's name.

As of September 30, 2007, investments in government securities and equities with a market value of \$1.6 million were exposed to custodial credit risk. As of September 30, 2006, investments in commercial paper, government securities, and equities with a market value of \$22.5 million were exposed to custodial credit risk. These securities

were uninsured, not registered in MEDC's name, and held by the counterparty. MEDC does not have a policy for limiting custodial credit risk.

- (3) Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. GAAP requires disclosures of the credit quality ratings of investments in debt securities. MEDC had the following policy for controlling credit risk of debt securities in fiscal years 2006-07 and 2005-06. Short-term investments (less than one year) shall have a credit rating of not less than A-1/P-1. Long-term investments shall have a credit rating equal to BBB or better. The average quality rating of the fixed income portfolio shall have a credit rating of BBB or better.

The following table shows the credit quality ratings of investments in debt securities as of September 30, 2007:

Investment Type	Fair Value	Credit Quality Rating	
		Standard & Poor's	Moody's Investors Service
Government securities - U.S. agencies	\$ 911,149	AAA	Aaa
Money market fund	20,477,678	AAA	Aaa
Total investments	<u>\$21,388,827</u>		

The following table shows the credit quality ratings of investments in debt securities as of September 30, 2006:

Investment Type	Fair Value	Credit Quality Rating	
		Standard & Poor's	Moody's Investors Service
Commercial paper	\$ 6,238,319	A-1+	P-1
Commercial paper	1,364,747	A-1	P-1
Government securities - U.S. agencies	13,301,409	AAA	Aaa
Money market fund	3,114,266	AAA	Aaa
Total investments	<u>\$24,018,741</u>		

- (4) Foreign Currency Risk: Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of investments or deposits. As of September 30, 2007 and September 30, 2006, MEDC did not have any investments in foreign securities.
- (5) Concentration of Credit Risk: Concentration of credit risk is the risk of loss attributable to the magnitude of MEDC's investments with a single issuer. MEDC does not have a policy limiting the dollar value of investments with a single issuer.

At September 30, 2007, MEDC had investments in the following issuer for more than 5% of MEDC's total investments:

Name of Issuer	Amount	Percent of Investments
Onset BIDCO	\$2,000,000	7.92%

At September 30, 2006, MEDC had investments in the following issuers for more than 5% of MEDC's total investments:

Name of Issuer	Amount	Percent of Investments
Federal Home Loan Bank	\$2,397,744	8.28%
Federal Home Loan Mortgage Corporation	\$2,418,016	8.35%
Federal National Mortgage Association	\$8,185,650	28.28%
Onset BIDCO	\$2,000,000	6.91%

Note 3 Loans Receivable

Loans receivable consisted of the following:

	As of September 30	
	2007	2006
Urban Land Assembly Fund loans	\$ 4,961,039	\$ 6,263,022
Seed capital loan	3,400,000	3,400,000
BIDCO loans	1,951,252	2,151,932
Life Sciences Program	5,470,199	4,693,374
Michigan Core Community Fund Program	12,647,173	12,890,688
Other loans	8,936,944	9,289,230
Total	\$ 37,366,607	\$38,688,245
Less: Allowance for uncollectible loans	(9,400,000)	(9,400,000)
Total loans receivable	<u>\$ 27,966,607</u>	<u>\$ 29,288,245</u>

Loans included in the "Other loans" category are collateralized, for qualifying projects, on the basis of participating up to 50% with other public or private lenders. The current portion of loans receivable includes those payments expected to be received during the next fiscal year.

MEDC provided no additional allowance for losses during the fiscal year ended September 30, 2007 for loans receivable that may be converted to grants or uncollectible in future years. Allowances for loan losses are reduced for the amounts recovered, BIDCO credits, and write-offs for the nonperforming loans. These loans generally provide for no principal or interest payments during the term of the loans. Some of these loans are expected to be converted to grants at the end of their term provided that certain conditions are met by the borrowers. The conditions generally require the borrowers to continue to conduct their principal business activities in the State of Michigan and submit specified reports to MEDC.

Note 4 Capital Assets

MEDC recorded its capital assets at cost and depreciates them over their useful lives using the straight-line depreciation method (30 years for building

and improvement, 3 years for furniture and equipment). Capital asset activities for the fiscal year ended September 30, 2007 were as follows:

Capital Assets	Beginning Balance	Increases	Decreases	Ending Balance
Building and improvement	\$ 13,086,970	\$	\$	\$13,086,970
Furniture	2,565,941	60,443		2,626,384
Non-EDP equipment	78,265			78,265
EDP equipment	852,890	93,035		945,925
Capital assets (cost)	<u>\$ 16,584,067</u>	<u>\$ 153,478</u>	<u>\$ 0</u>	<u>\$16,737,545</u>
Less accumulated depreciation for:				
Building and improvement	\$ (2,208,158)	\$ (436,608)	\$	\$(2, 644,766)
Furniture	(2,481,464)	(48,335)		(2,529,799)
Non-EDP equipment	(78,265)			(78,265)
EDP equipment	(797,117)	(48,318)		(845,435)
Total accumulated depreciation	<u>\$ (5,565,004)</u>	<u>\$ (533,261)</u>	<u>\$ 0</u>	<u>\$ (6,098,265)</u>
Capital assets (net)	<u>\$ 11,019,063</u>	<u>\$ (379,783)</u>	<u>\$ 0</u>	<u>\$10,639,280</u>

Capital asset activities for the fiscal year ended September 30, 2006 were as follows:

Capital Assets	Beginning Balance	Increases	Decreases	Ending Balance
Building and improvement	\$ 13,086,970	\$	\$	\$ 13,086,970
Furniture	2,497,430	68,511		2,565,941
Non-EDP equipment	78,265			78,265
EDP equipment	852,890			852,890
Capital assets (cost)	<u>\$ 16,515,555</u>	<u>\$ 68,511</u>	<u>\$ 0</u>	<u>\$ 16,584,067</u>
Less accumulated depreciation for:				
Building and improvement	\$ (1,771,550)	\$ (436,608)	\$	\$(2,208,158)
Furniture	(2,459,311)	(22,153)		(2,481,464)
Non-EDP equipment	(78,265)			(78,265)
EDP equipment	(743,172)	(53,945)		(797,117)
Total accumulated depreciation	<u>\$ (5,052,299)</u>	<u>\$ (512,705)</u>	<u>\$ 0</u>	<u>\$ (5,565,004)</u>
Capital assets (net)	<u>\$ 11,463,257</u>	<u>\$ (444,194)</u>	<u>\$ 0</u>	<u>\$ 11,019,063</u>

Note 5 Long-Term Liabilities

Long-term liabilities are accrued when incurred. The following table summarizes the Capital Access Program (transferred to MSF in fiscal year 2005-06) and compensated absences liabilities of MEDC for the fiscal years ended September 30, 2007 and September 30, 2006, respectively:

Fiscal Year 2006-07					
	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Compensated absences	\$2,722,354	\$1,076,712	\$1,236,157	\$2,562,909	\$1,279,003

Fiscal Year 2005-06					
	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capital Access Program	\$4,317,956		\$4,317,956		
Compensated absences	\$3,220,357	\$621,805	\$1,119,808	\$2,722,354	\$1,178,787

Note 6 Pension Plans and Other Postemployment Benefits

Classified Employees:

State classified employees detailed to MEDC are covered by two single employer plans offered by the State of Michigan: the State Employees' Defined Benefit Retirement Plan and the State Employees' Defined Contribution Retirement Plan (Plans). Detailed information regarding the Plans' descriptions, accounting policies, vesting and eligibility requirements, actuarial cost methods and assumptions, funding status and requirements, and 10-year historical trend information are provided in the Plans' detailed financial reports.

In addition to the Plans, State classified employees have the option to invest a portion of their salaries into 401k and 457 deferred compensation plans. Generally, MEDC does not make any contributions to the deferred compensation plans.

State statutes provide retired employees with other postemployment benefits, such as health, dental, vision, and life insurance coverage based on vesting and other requirements. The cost of retiree health care and other benefits is

allocated by the Office of Retirement Services and funded on a pay-as-you-go basis.

For the Defined Benefit Retirement Plan, MEDC was billed and paid an average 21.0% (\$1,773,682) and 26.8% (\$2,257,389) of its payroll costs for pension charges and retiree postemployment benefits in fiscal year 2006-07 and 2005-06, respectively. For the State Employees' Defined Contribution Retirement Plan, MEDC is required to make a contribution of 4% of the annual payroll and to match employee contributions up to 3% of annual covered payroll. MEDC's contributions for the Plan were \$190,186 and \$187,155 for fiscal years 2006-07 and 2005-06, respectively. The Plans' detailed financial statements can be obtained from the Office of Retirement Services, Department of Management and Budget, 7150 Harris Drive, P.O. Box 30171, Lansing, MI 48909.

Nonclassified Employees:

MEDC offers a retirement plan (under Section 401(a) of the Internal Revenue Code) to nonclassified employees after one year of service. MEDC also offers a deferred compensation plan (under Section 457 of the Internal Revenue Code) to nonclassified employees upon employment. Both plans are administered by ING, a third party administrator, and the employees manage their own investments.

On August 5, 1999, the MEDC Executive Committee approved an employer contribution rate of 8% of an employee's gross wages to the 401(a) retirement plan for eligible employees. Employees cannot contribute to this plan. For the fiscal years ended September 30, 2007 and September 30, 2006, MEDC made contributions to the plan of \$223,729 and \$205,603, respectively.

MEDC makes no contributions to the 457 deferred compensation plan. Only employees make contributions to the plan. For the fiscal years ended September 30, 2007 and September 30, 2006, MEDC employees contributed \$200,047 and \$125,192, respectively, to the plan.

Note 7 Revenues From MSF

Revenues from MSF consisted of the following:

	Fiscal Year	
	2006-07	2005-06
Tribal gaming revenue and fees	\$ 28,898,619	\$ 1,307,097
State's General Fund programs	28,886,831	32,651,928
Other State restricted programs	106,524	861,572
Total revenues from MSF	<u>\$57,891,973</u>	<u>\$34,820,598</u>

Note 8 Tribal Gaming Revenue

MEDC receives tribal gaming revenue from the Keweenaw Bay Indian Community under a consent judgment with the U.S. Department of the Interior, the U.S. Department of Justice, and the Governor. MEDC receives a semiannual payment from the Keweenaw Bay Indian Community in an amount equal to 8% of the net win derived from all class III electronic games of chance. MEDC recorded tribal gaming revenue of \$2.7 million in fiscal year 2006-07 and \$2.6 million in 2005-06.

In addition, MEDC previously received tribal gaming revenue from MSF. However, the two tribes remitting funds to MSF discontinued making payments in fiscal year 2003-04. The tribes contend that the Club Keno game, introduced by the Bureau of State Lottery, violates the terms of the 1998 compact agreement with the State. The State of Michigan and MEDC filed a lawsuit challenging the defendants' withholding of payments and seeks an order compelling full payment of these funds. The U.S. District Court for the Western District of Michigan issued its opinion and order on April 27, 2007, and its final judgment on June 18, 2007, in favor of the State and MEDC that the tribes breached their obligation to make the payments required by their compacts with the State. The tribes appealed the judgment. However, effective March 2008, the State of Michigan and MEDC reached a settlement with the tribes. The general terms of the settlement were that lottery and similar activities by the State would not be considered commercial gaming, the tribes geographic gaming exclusivity would be reduced from Statewide to the tribes' competitive market area, and the State's percentage of tribal gaming revenue would be reduced to 6%. In addition, the tribal gaming revenue held

in escrow during the dispute would be divided equally between the State and the tribes.

This settlement was reached after the end of the fiscal year. MSF initially receives the tribal gaming revenue and then transfers it to MEDC. MEDC recognized \$26.9 million of tribal gaming revenue and a current receivable due from MSF on the financial statements. In accordance with State policy, the Office of Financial Management, Department of Management and Budget, issued a waiver to MEDC to present financial statements different from the *SOMCAFR* because the settlement occurred after the issuance of the *SOMCAFR*.

Note 9 Commitments

Of the total net assets (\$108,422,166 and \$87,603,484, respectively), a portion is committed for the following economic development projects as of September 30, 2007 and September 30, 2006:

	2007	2006
Access Technology - North Coast	\$ 125,000	\$ 150,000
Automotive Technological Accelerator		239,950
Core Communities II	75,000	634,597
Economic Development Job Training Program	11,978,270	13,569,002
Emerging Technology Fund		35,000
Entrepreneurial Incubator Program	219,512	
Life Sciences Program	877,177	2,035,677
Marketing	100,483	238,980
Michigan Core Community Fund Program	2,679,589	2,434,139
Michigan Growth Fund	5,000	5,000
Minority Investments	1,805,255	1,959,624
University Matching Research	195,629	339,861
Urban Land Development	3,878,462	2,379,290
Total	\$ 21,939,377	\$ 24,021,120

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters

Mr. James C. Epolito, President and Chief Executive Officer
Michigan Economic Development Corporation
300 North Washington Square
Lansing, Michigan

Dear Mr. Epolito:

We have audited the financial statements of the Michigan Economic Development Corporation, a discretely presented component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2007 and September 30, 2006, as identified in the table of contents, and have issued our report thereon dated April 16, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Michigan Economic Development Corporation's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Michigan Economic Development Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Michigan Economic Development Corporation's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed in the next paragraph, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood

that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency described in Finding 1 to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described in the third paragraph of this section is not a material weakness.

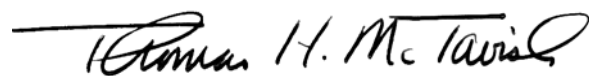
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Michigan Economic Development Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The agency preliminary response to the finding identified in our audit is included in the body of our report. We did not audit the agency preliminary response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Michigan Economic Development Corporation's Executive Committee, others in the entity, and the Legislature and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

A handwritten signature in black ink, reading "Thomas H. McTavish". The signature is fluid and cursive, with a horizontal line extending to the left from the first letter.

Thomas H. McTavish, C.P.A.
Auditor General
April 16, 2008

**FINDING, RECOMMENDATION,
AND AGENCY PRELIMINARY RESPONSE**

FINDING

1. Financial Reporting

The Michigan Economic Development Corporation's (MEDC's) controls over financial reporting did not detect a misclassification of revenue in its draft financial statements. As a result, investment revenue of \$1.6 million was misclassified in the fiscal year ended September 30, 2007 draft financial statements.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

MEDC properly recorded the financial transactions of \$1.6 million of realized investment gains and losses in the trial balance accounts. However, when MEDC compiled the detailed trial balance into the financial statement format, it reported the realized investment gains and losses with investment earnings rather than with unrealized gains and losses in the net increase (decrease) in fair value of investments. Governmental Accounting Standards Board (GASB) Statement No. 31 states that realized gains and losses should not be displayed separately in the financial statements from the net increase or decrease in the fair value of investments (unrealized gains and losses). MEDC corrected the reporting error at our request and the investment gains and losses were properly classified in the financial statements.

RECOMMENDATION

We recommend that MEDC design controls over financial reporting to detect misclassifications of revenue in its financial statements.

AGENCY PRELIMINARY RESPONSE

MEDC agrees with the recommendation. The misclassification was in the draft financial statements provided to the Office of the Auditor General (OAG) staff. It was corrected immediately once notified by the OAG staff. MEDC informed us that it has now made changes to internal control processes and procedures for the review of financial statements to detect such misclassification of revenue.

GLOSSARY

Glossary of Acronyms and Terms

BIDCO	business and industrial development corporation.
control deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are presented fairly in all material respects in conformity with the disclosed basis of accounting.
GAAP	accounting principles generally accepted in the United States of America.
GASB	Governmental Accounting Standards Board.
IDRB	industrial development revenue bond.
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
material misstatement	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.

material noncompliance	Violations of laws, regulations, contracts, and grants that could have a direct and material effect on financial schedule and/or financial statement amounts.
material weakness in internal control over financial reporting	A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial schedules and/or financial statements will not be prevented or detected.
MEDC	Michigan Economic Development Corporation.
MSF	Michigan Strategic Fund.
OAG	Office of the Auditor General.
significant deficiency in internal control over financial reporting	A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial schedules and/or financial statements that is more than inconsequential will not be prevented or detected.
<i>SOMCAFR</i>	<i>State of Michigan Comprehensive Annual Financial Report.</i>
unqualified opinion	An auditor's opinion in which the auditor states that the financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting.

